RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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**June 12, 1991** **LETTER 1071**

**THE MARKET:** Well, it finally happened. On May 31 the D-J Industrial Average confirmed the prior upside breakout of the Transports. By the close of trading on May 31 both Averages had rallied out of their three-month trading range -- Transports to a new recovery high, Industrials to a new all-time high.

What do the breakouts by both Averages mean? Robert Rhea, the great Dow Theorist of the 1930s, noted that in certain instances, an extended market consolidation or trading range can take the place of a correction. And that's what we've seen during the period of February to the present -- a trading range. Rhea further observed that following an extended trading range, if both Averages rally out (above) the trading range, it is an indication that considerable accumulation had taken place and that the primary trend is bullish.

So from a Dow Theory standpoint I have to believe that the Averages have spoken, and that they have said that the primary trend is up and has been up all along. As I see it today (with the advantage of hindsight, of course), the primary trend has been, and remains, bullish. But I also have a number of serious caveats. Based on values and based on the pattern of the averages, I continue to view all the action since the 1987 peak (Dow 2722.42) as part of a massive and continuously-building top.

**PTI:** I've stated over and over that this market is very expensive and extremely overvalued. But if we're not dealing with values, then what are we dealing with? My feeling is that people have been buying stocks mainly because stocks have been going up -- buyers have simply been following the trend.

Which is where my Primary Trend Index (PTI) enters the picture. I've always presented the PTI as my "fail safe" indicator, the indicator that, by its construction, would keep us on the right side of the market. The PTI is an amalgam of eight "action of the market" indicators. I might add that these eight indicators are not based on sentiment, psychology or contrary opinion, they are based on the action of the market itself.

The PTI doesn't care about opinions, values, the economy, what the Fed is doing or anything else. The PTI is only interested in what the majority of those eight indices are doing.

On January 31, 1991, the PTI turned bullish when it rose above its 89-day moving average. The PTI has remained bullish ever since. For those of my subscribers who invest strictly on the trend of the PTI, the action of January 31 provided the big buy signal. When the PTI turns bullish, you don't ask why, you don't argue, you don't figure -- you just buy.

One of the concepts I use but for some reason have never talked about is my "good day, bad day" concept. It runs like this -- in a strong, bullish market you just can't get a totally bad day. In a strongly bearish market, you just can't get an across-the-board good day.

I'll illustrate. Currently, although the market is overvalued and although there are many cross-currents, it is notable that you just can't get a "bad day." For instance, the Dow may drop 15 points on a given day, but the Transports will be up or the breadth will be up or new highs will outnumber new lows or the plurality of the most-active stocks will be up or the S&P will be up or the utilities or bonds will be up. In other words, even if "the market" appears

**May 31 DJIA 3027.50; PTI 3310; A-D Ratio -10.54**
**June 7 DJIA 2976.74; PTI 3299; A-D Ratio -11.05**
**Dow Yield: 3.05%; Dow P/E: 19.8; DowPow: 49**
**Dow 200-day MA: 2706; Dow 30-day MA: 2925**
**Dow Book Value: 1276; PTI 89-day MA: 3238**
**Percentage of Undervalued Blue-chips: 13%**

down, it is never unanimous, across-the-board weakness, there are always some key averages or indices that are bucking or negating the trend.

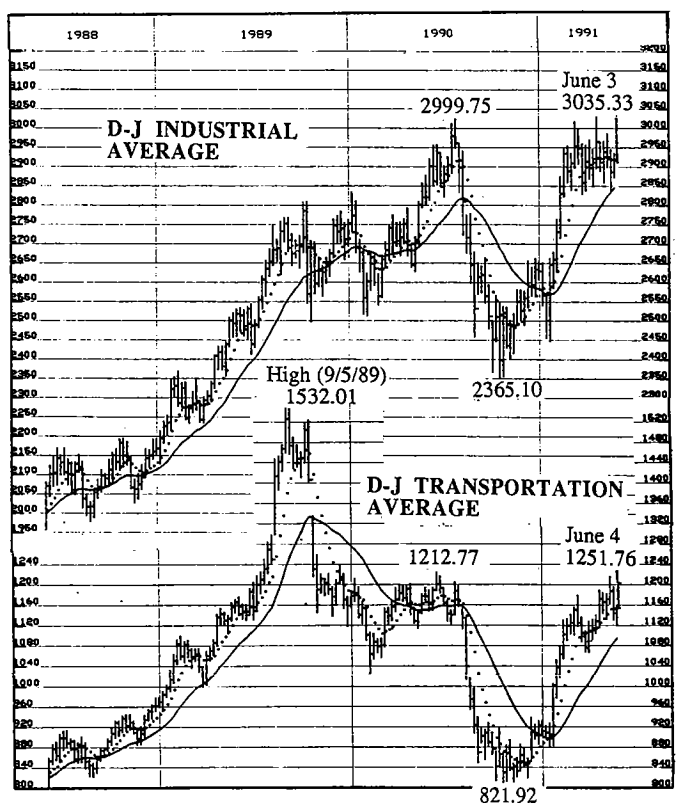
Conversely, in a true bear market everything will be falling apart. You can't get a "good day" on the upside, even during the strongest rallies. As I said, today, watching the daily action, this market won't (or hasn't up to now) given us "an across-the-board bad day." That's a sign of continuing internal strength.

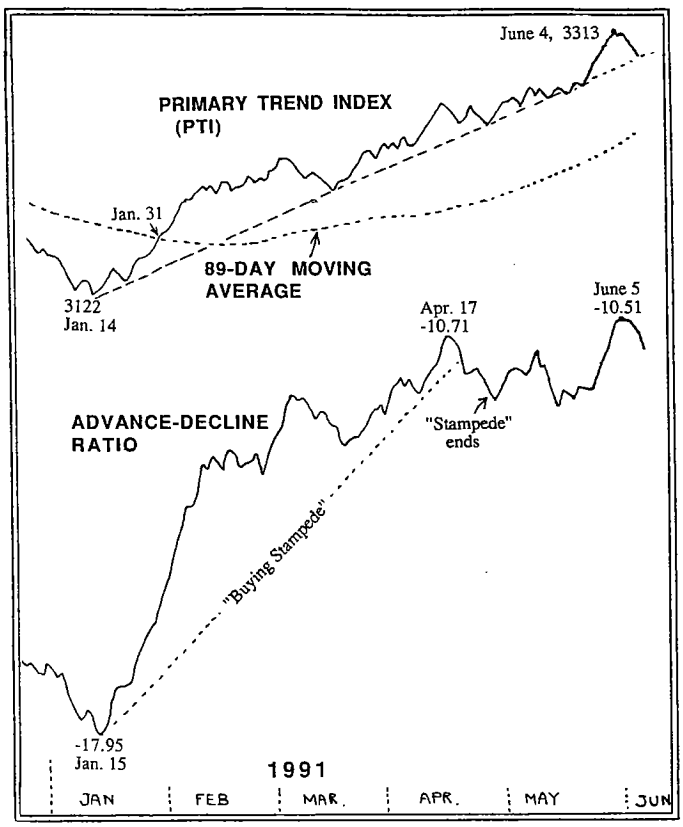
**And that's exactly what the PTI measures. When this action changes, my PTI will turn down on a trend basis.**

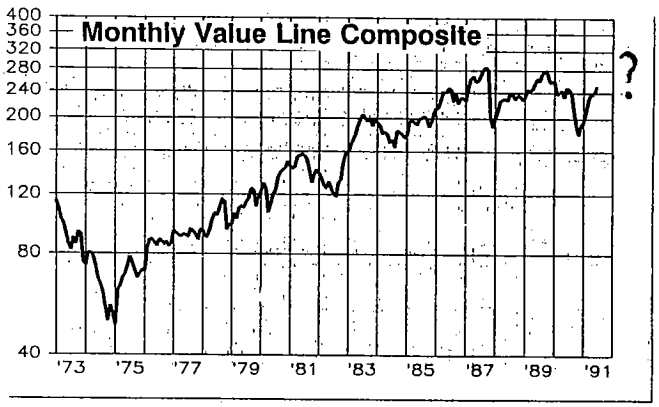
Despite the bullish PTI action (as subscribers must know by now), I've hardly been in love with this market. I grew up in this business respecting values, and even at last October's lows, I never considered stocks to be "great values." But as the Tina Turner song goes, "What's love got to do with it?"

A number of things continue to bother me here. One is the profile of the Value Line Composite, which I have used as a proxy for the typical or average investor's portfolio. As you can see, the Value Line hasn't been a winner. In fact, the Value Line has, so far, been unable to climb back to its 1987 pre-crash high.

Another item that bothers me: the high for the Dow in 1987 (just prior to the crash) was 2722.42. Last week the Dow was at 3020.






This represents an increase of 11.1% for the Dow over a period of four years. Now consider the following. The average yield on the Dow over the four years since 1987 was 3.54%. Add 2.6% a year for growth and we get an average annual return of 5.7% for the Dow since 1987. The average yield for T-bills over the same four years was 7.26%. Thus, there was actually a 1.5% advantage in holding T-bills as opposed to the Dow since the 1987 high (plus the added advantage that you pay no state taxes on T-bill interest).

What does this strange disparity mean? Frankly, I'm not entirely sure what it means when T-bills outperform stocks in a bull market over a period of four years, but I hardly think it's a promising performance. One thing it could mean is this -- based on business conditions, based on the fundamental position of the US in the world economy, stocks are fully priced and offer more risk than T-bills. Or at least that's been the case over the past four years.

A lot of people have moved into this market, and a lot of people still want to get into it. When I say "people," I'm talking about "the little guy," the public. John McGinley Jr. in his excellent *Technical Trends* report (PO Box 792, Wilton, CT 06897) lists some proofs of this statement. (1) Schwab orders are now 9,000 per day, up from 6,000 last December. (2) Brokers (believe it or not) are being rehired. (3) Cash and margin accounts are now buying, a switch. (4) Current large number of secondaries -- they're sold mostly to individuals. (5) More people own stocks now than before the '87 crash. (6) Half of existing mutual funds (do you believe this!) have been created since the '87 crash. There are now 3,242 mutual funds! (7) Most of the money inflow to the market has been in less than 10,000 share lots. (8) Junk bond funds being bought again. (9) More money going into stock funds now, rather than bond funds. (10) OTC volume now equalling NYSE volume. (11) Money funds down the last six weeks. (12) Interest in news letters up big (they've been dead since crash). (13) People with no previous interest in stocks now clammering to buy.

Is this all bad? What's wrong with the public becoming enthusiastic about the stock market? Nothing, except that public enthusiasm represents a change in sentiment. When the public becomes excited about the market, it's almost a guarantee that large investment interests will use that excitement as an opportunity to distribute stocks. Sophisticated investors don't sell their wares in areas of pessimism, they sell stocks when the crowd is hot for them.

History tells us that crowd enthusiasm ("feeding frenzies") can last a few weeks to many months. But the aftermath of crowd enthusiasm is always the same -- the market runs into trouble.

**MORE ON DOW THEORY AND VALUES:** Looking back over history, most of the money I've made in the market has been when I operated according to Dow Theory procedure. That means buying great values at or near bear market bottoms. When I loaded up with stocks in 1949-51, and in 1974-75 and again in 1982, the eventual profits were large, very large.

I've said this before, but I'll repeat it -- the big money can only be made when you take a big position in the market. And psychologically, I've only been able to take big positions when I felt I was buying real values -- stocks that were paying well-covered, attractive dividends.

If you study the page 2 chart (*IQ Trends*) in the last Letter you will note that at no time since the 1987 crash lows have stocks ever moved down to the area of great values, the bargain area. This is the area where 75% or 80% or more of the blue-chip stocks are undervalued.

So on a value basis, stocks haven't been a buy, and they certainly aren't a buy now on a value basis. To give you can example, if you look at the next-to-last page of *Barron's*, you will see that the S&P 400 Industrial Stock Average is now selling at more than triple its book value. I believe that this is the highest valuation based on book for the S&P 400 Industrials in history.

**ECONOMICS:** A few years ago, as veteran subscribers may remember, I wrote that with towering debt and never-ending deficits, the US was faced with a situation which I described as **"inflate or die."** I should have added that there is a gray area in between, a sort of no-man's land in which inflation has temporarily cooled off while at the same time the economy slows down but essentially holds together.

I think that no-man's land is where we are now. I also believe that my warning of inflate or die still applies. However, there are a few changes in the picture that are worth discussing.

(1) It now takes considerably more credit (i.e., debt creation) to generate rising GNP and inflation. Consider this: the federal deficits are currently running at the rate of $1 billion a day, but despite this, inflation has simmered down to where there is only around 4-5% inflation today (at least that's what it is according to the government's figures).

(2) With the real (i.e., inflation adjusted) money supply figures lagging, the US economy has obviously been veering more toward recession than inflation. In order to jump-start the economy, the money supply will have to increase substantially. Will that occur? I don't know. And if it does occur, will such action stir up inflation? My bet -- yes.

(3) The money markets are now super-sensitive to inflation. At the slightest hint of rising inflation, the bond market will sell off and

the Utility Average (which is also very sensitive to inflation/deflation and interest rates) will decline.

In other words, whereas the US during the 1960s, '70s and even during the early '80s could get away with inflation, it's considerably more difficult to inflate the economy back into boom conditions today. Here's why. If inflation starts up again, gold will rally, bonds will go into the tank and the Utility Average will slide. When bond prices go down, long-term interest rates go up, and at this juncture a rise in interest rates will quickly abort any recovery.

(4) So far the Fed has been "walking the line," trying to stimulate the recessionary economy by lowering short-term rates, but at the same time being careful not to provide too much stimulation because of the Fed's fear of reviving inflation. I have felt all along that the last thing Fed Chief Alan Greenspan wants to be remembered for is being the man who reversed all the inflation-busting work of his predecessor, Paul Volcker. Actually, Greenspan has been nursing his dream of "zero inflation."

(5) Today we live in a global economy. International money moves en masse at the drop of a hat, and basically the big money looks for (a) safety, and (b) after safety, the best return. Germany is the king-pin of Europe, and in Germany if inflation hits 3% it is considered out-of-control. Therefore, German interest rates remain high, and most of the major European currencies revolve around the Deutsche mark. The Bundesbank has already shown that it does not care for the American formula of lower interest rates and high inflation. Therefore, the Fed is not as free as it used to be in the matter of lowering rates willy-nilly. A large spread between US interest rates and European rates impacts on the dollar (although it must be admitted that the US doesn't much care where the dollar goes and would, in fact, prefer a cheap dollar).

(6) Despite the major (Fed manipulated) drop in short-term interest rates, long rates have stubbornly refused to sink below 8%. Thus, the spread between the yield on the long bond (8.30%) and T-bills (5.72%) is a whopping 2.58%. It seldom gets larger. What's happening, I believe, is that investors are still hedging against inflation, and they are fearful of buying long-term Treasury bonds that yield less than 8%. In other words, they want the 2.58% premium to cover the risk of carrying a long-term bond.

So that's the picture. The "Inflate or die" syndrome is still valid. Today when people ask me, "Russell, how would you handle the deficits?," I tell them that at this point I no longer have any solutions. Oh yes, there is one thing -- if I were president, I would be honest with the American people. I would tell them frankly what is happening and what the actual deficit is. Currently, we are adding one billion dollars a day to the federal debt. I haven't heard Mr. Bush bandy that figure around in public.

**PRICE ACTION:** Many years ago (twenty-year subscribers may remember this) I did a study on the trend of the D-J Utility Average and the D-J 20 Bonds. I showed when these two Averages move in tandem, either up or down, the stock market almost always follows.

This study is particularly important now. I say that because the Utility Average has been lagging, and last week relative strength in the Utility Average broke to a multi-month low. With Utilities weak, the focus switches to bonds. The trend of bonds is particularly important now. Bonds must hold here. If bonds turn weak, the market is almost sure to follow.

The problem: If the US economy is strengthening as so many economists claim, it's hard to envision any sustained improvement without bonds going lower and long rates moving higher.

**INFLATION?** I keep asking myself this question, "If the economy turns up will inflation turn up with it?" Or the reverse: "If the Fed insists on keeping inflation below say 5%, can the economy really and convincingly turn up?" These may be the two key questions of the day (and the decade).

In mulling over these questions, we have to consider a number of rather new forces.

(1) As I've said many times, Fed Chairman Alan Greenspan is definitely anti-inflation, there's no doubt about it. I believe Greenspan would take a continued recession rather than see inflation heat up again. So far, Greenspan is taking the recession, even though he tries to jaw-bone the economy up whenever he's interviewed or whenever he appears before Congress.

(2) The public is now fully aware of the towering federal deficit figures. And they don't like them. Recent polls show that crime and the deficits are the two major concerns of the public. The deficit is also the number one engine of US inflation. So far, the Treasury has been able to sell securities with which to cover the deficits (rather than monetizing the deficits via purchases of securities by the Fed, which is inflationary).

But Treasury auctions are growing progressively larger. Will foreigners and domestics continue to buy US debt? Who knows, but they have so far.

Gramm-Rudmann was an idea that never worked. Since then, Congress has instituted laws which do have teeth in them. And there is increased pressure to cut government expenses (whether that will continue, we'll have to see). But cutting the deficits (on all government, state and city levels) is *deflationary*. It means unemployment, cancelled contracts and reduction of services. So will it continue? We'll see.

Item: this is the first recession in which taxes were raised and in which the federal government did not institute programs to stimulate the economy. The fact is that the money isn't there to finance new programs. That's a big change. And it's anti-inflationary.

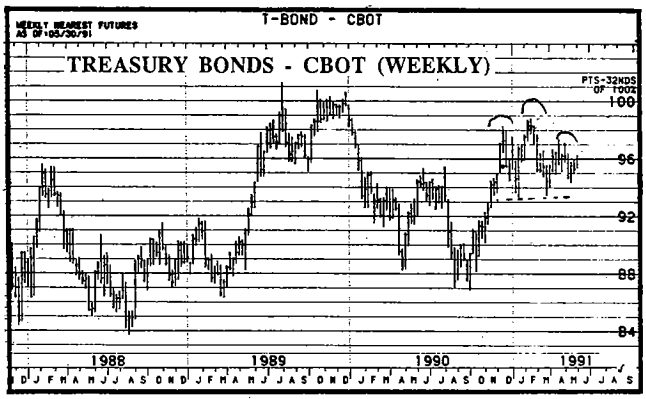
(3) Here's another big one -- 25% of voters in 1988 were over the age of 65. These "grey people" (and you know who you are) tend to be conservative. When younger they may have voted for new, expensive social programs, but today these same people are moving to Nevada, Texas and Florida to get the sun -- and to avoid taxes. The average age of the US population is steadily rising, and make no mistake about it -- these are the voters. The over-65s VOTE, and they don't like taxes and they don't like inflation and they don't like deficits. There's another rising pressure, and it's definitely anti-inflationary.

**INVESTMENT POSITION:** Yes, I've taken the bear out of the box and replaced him with Ferdinand, the reluctant bull. What to do? I'm not going to list all the evidence of market overvaluation again, but suffice it to say that this just isn't bargain time on Wall Street.

As I see it, this is strictly a trading market, and that means that if you buy stocks or mutual funds here you cannot do it with the complacency of a long-term investor who is buying the market at bargain basement prices and is willing to collect fat dividends and hold stocks through thick and thin -- until his purchases become overvalued. Stocks are overvalued now, and the buyers must realize that. So if you buy today you're buying in the hopes that your purchases will go up, and that you will be able to sell them at a profit to some other eager buyer.

Two no-load mutual fund families that I like are the Financial group and the T. Rowe Price group. For some reason, the Financial group has been doing a lot better than the Price group. I run most of the funds within each of these groups on relative strength charts. Right now, the best looking of the whole batch are the Financial group's Gold fund and its Financials fund.

**BONDS:** Here we see the bonds in what I call a dangerous formation. We have the highs of 1989, a big drop into 1990, then a second rise in 1991 with the peak below the 1989 high. A potential head-and-shoulders top has now formed. The critical level is 93. If the T-bonds break below 93, it's going to signal higher long rates on both bonds and mortgages. So let's watch it.




**NOTES & QUOTES:** Now It Can Be Told Dept: The deal: Gorbachev will give the West what it wants in return for something like $100 billion (what they really want is $50 billion a year for five years). In return the US wants economic reforms, a commitment from Gorby that there will be no military threats to the US, abandonment of aid to Cuba and a decent solution to the Baltic's desire for independence. Who's going to pay? The World Bank and the IMF would pay half. The rest is open to bargaining (the US would pay $3 billion and up a year). The big argument coming up -- would money to the Soviets be money down the drain? Is Gorby too timid to push for a free market? Russell opinion: I wouldn't give the Soviets a cent unless they cut their massive military spending and absolutely moved towards a market economy.

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Government people are flabbergasted at the rocketing rolls of people on welfare. The latest count shows that 12.5 million Americans are now on the dole (mostly children and their mothers). That's a record number, surpassing the 1981 peak. In California, the welfare rolls are expanding at the fastest rate in 20 years (meanwhile, tax receipts to the state of California have dropped for the fifth straight month).

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Japan is in a furor because of statements made by France's outspoken new Prime Minister, Edith Cresson. She stated in a TV interview, "It is the world that Japan seeks to conquer." That, by the way, is something I've been saying all along. What Japan couldn't do in the 1940s, it would like to do now -- that is, rule the world economically.

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The world birthrate (as of 1990) was 27 new births per 1,000 people. At the same time, the world death rate was at 10 per 1,000. This represents a growth rate of 1.8%, but less-developed nations led with a birth rate of 2.4%. This means that the world population doubles every 26 years. Does your business need customers? Sit tight, they're coming. On a more serious note, the waste and pollution problems which will arise from the world's exploding population will be massive.

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*Nelson's Outlook* monitors earnings forecasts on companies that trade publicly. In May, Wall Street analysts reduced their earnings forecasts on 1,169 companies while increasing their forecasts on only 598. This two-for-one ratio does not bode well for the trend of corporate profits.

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On May 30 James Reston, grand old man of the *NY Times* Washington bureau (he knows more about Washington than anyone) wrote his views on a few presidents: "Harry Truman and Dwight Eisenhower were good presidents because they recruited good people and didn't try to hit every pitch and field every grounder. Franklin Roosevelt benefited from his physical handicap because it forced him to sit in a room and think. This art is no longer popular on the banks of the Potomac. Jimmy Carter was a technocrank who couldn't see the forest because he was counting the leaves. Ronald Reagan sat in a room a lot but didn't think much, and George Bush is over-active because he has a hyper-thyroid, or maybe vice-versa. He loves sports but he doesn't watch them, he attacks them. He stretched a single into a triple in Iraq, and then didn't walk to home plate when he had a chance. He doesn't walk but he jogs when he isn't running or flying off somewhere. He doesn't just fish and pitch horseshoes, but he plays golf, the punishment for man's sins, and his golf style is similar to his policies; good back swing, no follow through. He's always getting into or out of helicopters and waving to people, even when they aren't there . . . So we have a problem and not only with the President and his pinch hitter, Dan Quayle, and his designated hitter, Jim Baker. Everybody's in a hurry, not to deal with problems at home, but to establish a new world order, by war if necessary, and to establish democracy in areas that don't understand it or want it."

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According to an article by Charles Wolf, Jr. in the May 26 *NY Times,* the following are the basic reasons for Japan's industrial power. Investment: Japan's rate of aggressive domestic investment is 24% of GNP compared with 16% in the US. Savings: Japan domestic savings in the late 1980s averaged 28% of GNP, compared with the US' 13-14%. Labor: the Japanese labor force is highly disciplined, trained, industrious and literate. Management: Japanese managers are energetic, industrious, competent and experienced. They are on a continuous search for better quality and lower production costs.

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Speaking of Japan, I continue to feel that the Nikkei could be the bellwether barometer for the world in the 1990s. The Japanese stock market was the world leader (on the upside) for decades. The Nikkei did not really participate with the Dow in the 1990-91 advance (see last Letter). If the Nikkei leads the way down now, there's going to be global trouble. In March, Japanese leading economic indicators fell to their lowest level in a decade. On June 5, the Nikkei index closed below 25,000 for the first time since February.

Morgan Stanley notes that "the warning flags are flying for the Japanese banks. Undercapitalized and over-extended with their funding edge eroding, it is hard to see why they merit the extravagant valuations they receive" (some are selling at 100 times earnings).

Japanese stocks are down from their outrageous 1989 prices (today they are just HIGH). How about this -- at its 1989 high, Nomura alone had a greater market value than ALL the rest of the stocks in the world with the exception of IBM and Exxon!

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More Americans depend on income from interest-bearing securities than ever before. *American Business Econometrics,* using their own computer model, states that net Fed easing has stimulated the economy to the tune of about $18 billion. But that amount is offset by a loss of $34 billion in interest income, leaving a net loss of $16 billion. Their conclusion: "In the current financial environment . . . for every dollar of income gained in wages and salaries as a result of lower rates, two dollars are lost in interest income."

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Along the same lines the "Current Yield" section of *Barron's* is headlined, "Your Best Investment May Be None At All." To clarify, the column notes that "loan costs have remained stubbornly high" while interest rate returns to investors remain on the low side. So the best investment for a lot of people would be to pay down or pay off their mortgages rather than put money into a CD or a money market fund. And the fact is, states *Barron's,* that there is a surge in mortgage repayments. So the best investment for the average person at this point is probably -- paying off debt.

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Progress: In 1986 when Gramm-Rudman balanced budget law took place, the deficit was $221 billion. After that five years of political argument and wrangling occurred. Last fall Congress and the Bush boys raised taxes, and at the same time they promised the new round of taxes would lower the deficit. Result: for 1992, the estimated deficit is $278.8 billion.

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A front page article in the May 28 *NY Times* states that "almost new" cars are really hurting new car sales. The auto fleets are

delivering a double whammy to the car manufacturers. First the fleets buy the new cars from the factories at a discount. Later the fleets sell their cars, and the public buys them at bargain prices, thereby foregoing the new cars.

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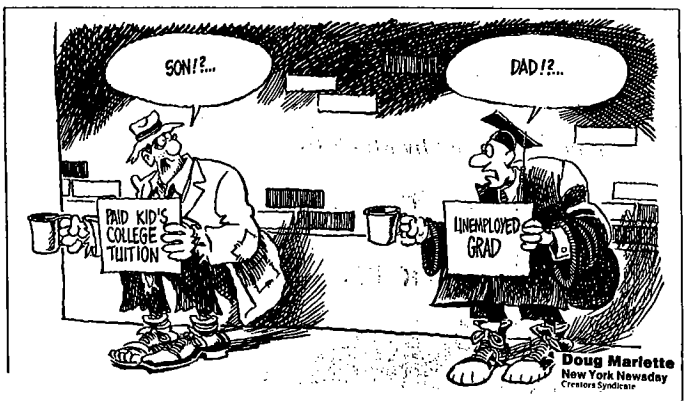
The squeeze on Americans continues with taxes rising, interest income falling, core inflation items holding steady or rising, housing prices soft and jobs hard to get. The cartoonists are beginning to pick it up, and here's a typical example. Dad's broke after paying college tuition (which is over $20,000 a year at Ivy League colleges), and Sonny is broke because he can't find a job.

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This is from the May 20 *New York* magazine: "Raising taxes in a weakening economic environment is almost invariably a prescription for disaster. For proof, one need look no further than the devastating impact that Bush's 10% 'luxury tax' has had on the pleasure-boat industry. Sales of yachts costing $100,000 or more -- the target of the tax -- were already weak when the levy went into effect this past January. Yet since then, the tax has virtually destroyed the industry."

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The US will be cutting its NATO European forces in half. Reason: the former "Soviet enemy" is looking less and less like an enemy. The big defense cutback is slowly gaining momentum. In California, the LA Chamber of Commerce just released a major report. It was a shocker. The report says that the defense industry accounts for up to 1.4 million California jobs -- 9% of the state's total employment. In the last four years the state has lost 150,000 defense and related industry jobs. With continued defense budget cuts, the state can expect to lose 250,000 to 375,000 more such jobs in the next five years. One fifth of manufacturing jobs in California are in aerospace. On top of all this, the business environment in California is now negative with high taxes, air-quality restrictions, lack of financial incentives, high-priced housing and clogged transportation. As in the case of NYC, many businesses are now lining up to leave the former Golden State.

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More on California: For decades the West Coast has led the nation in trends for cars. Here are some items from very fast-growing San Diego County. Last year, incredibly, Mercedes led Plymouth in car sales. Last year, again incredibly, foreign car sales in San Diego County amounted to 63% of all car sales (nationwide foreign car sales are 30%). The number of car dealers in San Diego County is down 10% over the last 18 months. States Roger Sathers, President of the New Cars Association of San Diego, "It's just devastating. Everybody's traffic is way off, sales are way off. There are no signs it is coming back at all. Everybody is cutting prices."

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My good friend, Nancy Dunnan, writing for The Inside Track Library, has come out with four excellent basic books, Banking, Entrepreneurship, Collectibles and The Stock Market. These four books were written for youngsters, but I must admit that I found them clear, very informative and worthwhile. For instance, on page 49 of the Banking book we read, "Every year more than $1 billion in property goes unclaimed. The government estimates that one in ten people is owed some type of unclaimed property, including bank accounts, utility deposits, insurance policies, stocks, bonds and even payroll or pension checks. How does this happen? Usually it's because people move and neglect to leave their new address, or their recorded address is incorrect" [For copies call (800) 843 3464].

* *

Corporate interest expenses are now eating up 56% of US firms' pre-tax profits. The result is that corporate expansion plans, which generate jobs and income, are being cut back or curtailed. During the first quarter, capital spending dropped 16%. Says Economist Lacy Hunt, "The pressure on earnings and the heavy commitment to debt servicing indicate that the downturn in capital spending is at a very early stage." Russell comment: this is the basic reason why the recovery is expected to be feeble. If capital spending is weak, job creation will also be weak. And that will not bolster consumer confidence or consumer spending. Consumer spending comprises almost two-thirds of GNP.

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Victory? From the June 10 *US News & World Report:* "As US forces hurry home, Saddam is rebuilding his power over the ravaged country, mounting an all-out effort to restore the appearance of normality. Electricity is returning to Baghdad and other areas, drinkable water is flowing in many areas, food is increasingly available, albeit at exorbitant prices. Almost half a million phones have been restored. On Iraqi TV, footage of hollow-eyed rebels 'confessing' to sabotage drives home the message: rebellion doesn't pay. Saddam appears to be 'in high spirits,' says Azzam al-Ahmad, the Palestine Liberation Organization representative in Baghdad, who recently met with the president. 'I felt he was very comfortable with the present situation in Iraq.'" Russell comment: yeah, great.

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How to end the Cuban problem? Easy, give Cuba a baseball franchise. You may not know it, but Castro was a good pitcher (he had a good fastball and an excellent curve ball), and he was actually offered a job in the late 1940s by the New York Giants. Castro is a big baseball fan and Cuba has always been mad about the game. So we give Cuba a franchise. Every kid in Cuba tries for the team and maybe future big money from the Americans. Led by the new baseball mania (and a cut-off of funds from the Soviets), Communism collapses in Cuba. Within a few years, Havana opens up again, casinos are built, Americans (I don't like this one) are smoking Cuban cigars and a changed Castro is throwing out the first ball in the new season. A fantasy? These days, who knows.

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The dollar still buys a hell of a lot more here in the US than a comparable amount of a foreign currency buys in Europe or Japan. I can walk into a California supermarket and with a ten dollar bill walk about with enough vegetables and pasta to feed me for a week (try doing this in London or Paris). On top of this, the weak bond market is pushing US interest rates up, making the holding of dollars more attractive. So the dollar has strengthened up considerably against the other "hard currencies," and dollar shorts have been taking a beating. Swiss francs have been particularly weak, but all the currencies from Dutch guilders to Belgian francs have sunk against the dollar.

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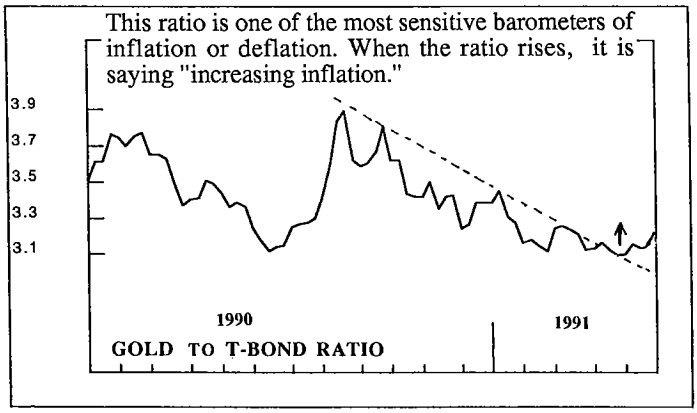
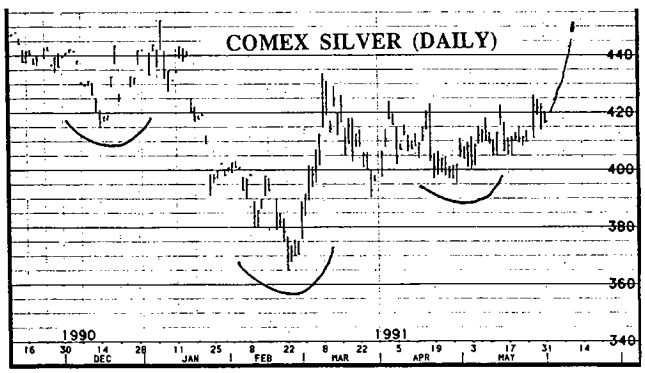
**GOLD:** Whew, the disinterest and negativity towards silver and gold has been almost climactic. Two weeks ago the little Spokane Stock Exchange closed its doors. The 94-year old Spokane Exchange dealt mainly with regional penny gold and silver mining stocks. The Exchange's volume peaked in the early '80s at $100 million. More recently, Spokane rarely traded more than $50,000 a day. Then, early last week, the Kemper group closed down its Kemper Gold Fund "because of its slow growth and weak outlook."

Their timing may have been off. Last week, ASA reversed a long declining trendline and gave a P&F buy signal at 48, moving over 50 a few days later. At the same time, the relative strength of the gold group strengthened, and most important, the ratio of gold to bonds reversed a 10-month declining trend to the upside -- in favor of gold. Gold and bonds are two of the most sensitive indicators of inflation. So when you take a ratio of the two, you have a super-sensitive inflation barometer. Consequently, when this ratio turns up, it's not happy news (watch out, Mr. Greenspan).



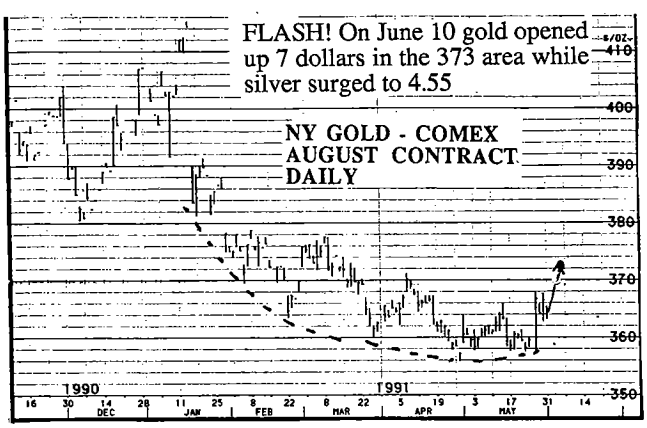

A few months ago the gold/silver ratio hit an outlandish 100 to 1, meaning that one ounce of gold would buy 100 ounces of silver. Some of us old timers remember when this ratio was around 15. If you've been a silver-phile, buddy, you've seen hard times. Silver has been lolling around in the basement -- the February low of 3.51 was a 17-year low.




But wait -- in the midst of the gloom, a base was forming. The chart shows a head-and-shoulders bottom for silver with upside resistance at 4.25 and again at 4.35.

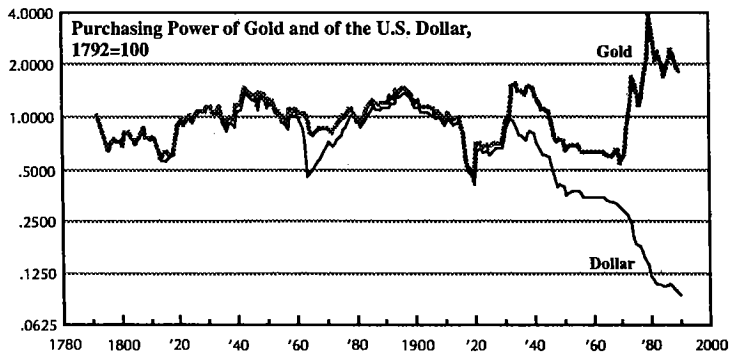
Then, on June 6, the *WSJ* came out with the news that silver consumption was outpacing demand (precious metals aficionados have known that for months). On June 6 gold jumped 2.40 while the more leveraged silver surged 24 cents. This good action on the part of silver took the metal above its March high and set the March contract trying for the 4.58 resistance level.

On the same day (June 6) gold closed up 2.40. With strength coming into gold, its upside target is now the March resistance peak of 378 (basis the August contract). Gold, as you can see on the chart, has etched out a "rounding bottom," and such formations usually indicate careful, patient accumulation. If so, we should see some interesting action in the metal shortly (charts courtesy of *CRB Futures Chart Service* ).




Gold and silver have made many false starts over the past decade, and the reaction to the recent action will probably be, "Oh gad, not another phoney pop in the metals." Are the cynics correct? Only time will tell, but I haven't sold any of my gold coins or gold mutual funds, and I'm still of the opinion that gold is cheap under 400. Furthermore, with the US running deficits of $1 billion a day (and that's just the federal government), the ratio of gold to debt keeps climbing and climbing.

Here's an interesting chart just published by *American Investment Services,* Gt. Barrington, Mass. 01230. It shows the purchasing power of both gold and the dollar going back to the late-1700s. Towards the end of the 1930s (as it became illegal for Americans to hold gold) the dollar began to lose purchasing power. Then came WWII and the big deficits, followed by big deficits ever since. The result -- a collapse in the dollar's purchasing power that has continued to this day. Gold in the meantime has gained in purchasing power. The spread between the purchasing power of gold and the dollar is now a giant gap. Greenspan knows all about this, and that's why he's so dead set against inflation (after all, he's living off a government salary).




Of particular interest now is the proposed merger of American Barrick (ABX) and Newmont Mining (NEM), two of North America's largest gold mining companies (both NYSE). If the merger goes through, it would make one of the largest gold producers outside of S. Africa. I have previously recommended ABX. But don't sneer at S. Africa's gold either. ASA (which is all the S. African participation you'll ever need) just rallied over 50 (its 1990 low was 36). ABX, which has been displaying superior relative strength all year, jumped to 21 7/8 on June 6. It s all-time high was a fraction over 24.

One easy way to play gold (aside from the accumulation of gold coins) is via a no-load gold mutual fund. Benham has one -- (800) 447-GOLD; the Financial group has one -- (800) 525-8085; Lexington has one -- (800) 526-0057; Blanchard has one -- (800) 877-7633.

**LATE NOTES:** Well, forget what I said earlier about this market refusing to produce "a bad day." We got one Friday, June 7 -- a baaad day, broad weakness with almost everything down and with 2.5 times as many declines as advances. That action gave me a sell signal on the McClellan Summation Index (based on breadth), and my PTI is again flirting with that rising trendline.

The action of the Averages of June 7 was hardly encouraging. The last thing the bulls wanted to see was the Dow dropping decisively below the psychological 3000 level again. But it happened, and the secret question in every investor's mind is -- "Was the breakout of the Transports to a new recovery high and the Dow 3000 a false one -- a bull trap? Or is the market simply backing off in order to scare out the Johnny-come-latelys?" Ah, if we only knew the answer to that one.

Well, I'll say it again -- the funds, the institutions, the public, they're all loaded with stocks. Their accounts are cocked and ready for the market to take off to new profitable highs. Will Wall Street oblige? Mmmm. Russell final comments: remember, VALUES are very thin here. And above all, watch the trend of BONDS, UTILITIES and the fast-sinking Japanese NIKKEI INDEX.

**NEXT MAILING: June 26**